

DOCKET FILE COPY ORIGINAL



R. E. Sigmon
Vice President - Regulatory Affairs

201 E. Fourth St., 102 - 320
P. O. Box 2301
Cincinnati, Ohio 45201
Phone: (513) 397-1260

December 10, 1993

RECEIVED

DEC 10 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

In the Matter of:

Amendment of Parts 32 and 64 of
the Commission's Rules to Account for
Transactions between Carriers and their
Nonregulated Affiliates

CC Docket No. 93-251

Dear Mr. Caton:

Enclosed for filing are the original and nine copies of
Cincinnati Bell Telephone Company's Comments in CC Docket
No. 93-251.

Please date stamp and return the duplicate of this letter as
acknowledgement of its receipt. Questions may be directed to
Robert C. Coogan on (513) 397-7820.

Sincerely,

A handwritten signature in dark ink, appearing to read "R. E. Sigmon".

Enclosures

No. of Copies rec'd
List A B C D E

A handwritten number "059" in dark ink, written over a horizontal line.

DOCKET FILE COPY ORIGINAL RECEIVED

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

DEC 10 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of:)
)
Amendment of Parts 32 and 64 of the)
Commission's Rules to Account for)
Transactions between Carriers and)
Their Nonregulated Affiliates)

CC Docket No. 93-251

COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY

Introduction

Cincinnati Bell Telephone Company (CBT) respectfully submits these comments in response to the Notice of Proposed Rulemaking (Notice) released October 20, 1993 in the above proceeding. In its Notice the Commission undertakes a reevaluation of the affiliate transaction rules adopted in the Joint Cost proceeding¹ which set forth federal accounting requirements for transactions between carriers and their non-regulated affiliates. The Commission proposes to amend those rules in a number of significant respects. In general, CBT believes that the proposed amendments are unnecessary and would impose an unwarranted burden upon the carriers. CBT will limit its comments, however, to specific proposals.

¹ Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298 (Joint Cost Order) recon., 2 FCC Rcd 6283 (1987) (Joint Cost Consideration Order), further recon. 3 FCC Rcd 6701 (1988) (Further Reconsideration Order), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

Prevailing Company Price

CBT is most concerned about the Commission's proposal which would severely limit the use of prevailing company prices for recording affiliate transactions.² Under the present rules, a transaction is recorded at the prevailing company price whenever the affiliate that provides the asset or service provides substantial quantities of it to non-affiliates. The Commission proposes to limit prevailing company pricing to affiliate transactions in which the non-regulated affiliate sells at least 75% of its output to non-affiliates.³ CBT believes that such a limitation on the application of prevailing company pricing is unwarranted and unnecessary.

In today's intensely competitive and innovative telecommunications marketplace, it would be highly improbable, if not virtually impossible, for an entity to sell any substantial quantity of a product or service to a non-affiliate at a price which was anything other than fair market value driven. Even if the Commission is correct in pointing out that affiliate transactions take place in a different environment from non-affiliate transactions,⁴ nevertheless the existence of substantial quantities of non-affiliate transactions lead to the inescapable conclusion that the pricing of those transactions is realistically market driven. The use of those prevailing prices represents fair value for the asset or service sold and can reliably be used to record comparable affiliate transactions. That reliability is maintained so long as there are any substantial number

² Notice, paragraphs 15-22, 82-85.

³ Notice, paragraph 22.

⁴ Notice, paragraph 18.

of non-affiliate transactions and becomes unreliable only if the non-affiliate transactions are insignificant. Assigning an arbitrarily determined high percentage of non-affiliate transactions before permitting the use of prevailing company price does nothing to increase the reliability that that price is fair. It merely assigns many more affiliate transactions to an administratively more complicated and expensive procedure of comparing costs and estimated fair market value.

Prevailing Company Price - 75% Test

The Notice proposes to restrict prevailing company pricing to affiliate transactions in which the non-regulated affiliate sells at least 75% of its output to non-affiliates.⁵ The Commission invites comment on two alternatives for measuring that output.⁶ If such an output measurement is required, CBT strongly recommends the second alternative, using the non-regulated affiliates' revenues from the immediately preceding year. Historic actual data are much more reliable than future estimated data. This approach also is consistent with the use of historical data in calculating certain fully distributed costs.

The Commission also seeks comment on whether its 75% of output test for applying prevailing company prices should be applied on a product, product line, line of business or total company basis.⁷ CBT believes that the inclination to apply the test on a broader basis than a product basis highlights the unnecessary severity of a 75% of output test. Focusing on product is far simpler than attempting to define product line or

⁵ Notice, paragraphs 15-22.

⁶ Notice, paragraph 82.

⁷ Notice, paragraph 86.

line of business and far less intrusive on the non-regulated affiliates' business than product line, line of business or total company analyses. CBT reiterates its belief that the current definition which requires a substantial number of transactions with non-affiliates is sufficient to protect ratepayers against cross subsidization. If the transactions are examined at the product level, the lowest level possible, the level of detail which offers the most control, the definition need not be as strict as it would be for the summary level categories such as total company level. If the term "substantial" must be quantified, then CBT recommends "substantial" be defined as "20% or more." CBT believes that this minimum threshold provides enough evidence that the product or service is being offered at a fair market price.

Increased Carrier Efficiency

In the Joint Cost proceeding the Commission adopted the current valuation rules for services because they would provide an incentive to offer the services in a more efficient manner. The Commission now questions this incentive and suggests abandoning fully distributed cost as a valuation method for certain affiliate transactions and asks that commentors list specific services where the use of fully distributed costs increases carrier efficiency.⁸ CBT sells incidental services such as conference room rental, medical services, and motor vehicle pool usage to affiliates at fully distributed costs. These fully distributed costs include a built-in rate of return which helps to offset regulated expenses that otherwise would be passed on to the ratepayer in the form of higher rates. These services are required for CBT's own operation and the use by affiliates is secondary.

⁸ Notice, paragraphs 32 and 33.

CBT's overall efficiency is enhanced by utilizing these resources to the fullest extent possible.

The Commission suggests that fair market value may be greater than costs. If this is the case, the incentive for affiliates to use CBT's service disappears. The offsetting revenue from the affiliates would cease and the ratepayer would suffer the loss. The costs method ensures complete recovery of costs plus a return on investment. The current valuation methods permit efficient use of resources and provide benefits for the ratepayer.

Deviation From Specified Valuation Methods

As the Commission points out, it has in general permitted deviation from the valuation methods specified in the affiliate transactions rules only for those services carriers sell to non-regulated affiliates which they propose to record at fully distributed costs plus a subsidy.⁹ The Commission seeks comments on alternative valuation methods that reduce regulated costs.¹⁰

First, the recording of services carriers sell to non-regulated affiliates at fully distributed costs plus a subsidy should continue to be permitted. The Commission expresses concern that carriers will book the cost portion into operating accounts and the subsidy portion below the line. This, of course, should not be permitted and it is not the manner in which CBT currently records such transactions. The costs plus subsidy amount is viewed as one fee to be booked in its entirety into operating accounts. This

⁹ Notice, paragraph 37

¹⁰ Notice, paragraph 38

valuation methodology provides a benefit to the ratepayer and should continue to be permitted.

There are other similar valuation methods that the Commission should permit without the need for a waiver of the rules. For example, sales by an affiliate to a carrier at less than fully distributed costs should be permitted without a waiver because the ratepayer unquestionably benefits from the discounted price. A more striking example occurs when an affiliate offers a service to a carrier at no charge. The use of unfilled space in a training class offered to the carrier by an affiliated company is an example.

Estimating, Monitoring, and True-up Procedures

CBT believes that, in estimating affiliate transactions costs as suggested by the Commission,¹¹ past experience should be used wherever possible and budget figures should be used only when past experience is not available. While actual costs should be monitored against estimated costs and a true-up performed if necessary, CBT believes that an annual true-up is sufficient and that no benefit would be derived from quarterly true-ups.

Identification of Certain Affiliates

The Notice proposes to require carriers to state in their cost allocation manuals which of their affiliates meet the test, whatever test is adopted, for using prevailing company pricing.¹² Such a separate statement seems unnecessary since it can fairly be assumed that, in identifying the terms of an affiliate transaction in the cost allocation

¹¹ Notice, paragraphs 77-81.

¹² Notice, paragraph 95.

manual, the use of prevailing company price will be limited to those affiliates which meet the test for the use of that pricing. Further, there would seem to be no need for updating such statements on a quarterly basis, since output is measured annually.

Proposed Rules

CBT believes that paragraphs 32.27(c)(2), (d)(3) and (d)(4) and 64.903(c)¹³ of the Commission's proposed rules are unduly vague and offer no guidance to the carriers. They would grant to the Commission de facto rulemaking authority without following rulemaking procedures. They should be deleted or rewritten.

Alternative Methodology for Small Tier 1 Carriers

While the Commission proposes to require all carriers subject to the affiliate transactions rules to comply with its proposed methodology for determining costs of affiliate transactions, it invites comment on whether it should modify the proposed methodology to reduce burdens on the small and mid-size carriers.¹⁴ CBT offers the following alternative methodology which would streamline the process, be easier to implement and administer, provide the same basic valuation results, be less costly to audit, and continue to provide protection against cross-subsidization. This proposal would significantly reduce the burden that the Commission's proposed methodology will impose upon small Tier 1 companies, which CBT would define as carriers having annual operating revenues less than \$1 billion as defined in the USTA Petition for Rulemaking, RM 8354. CBT proposes for small Tier 1 companies a modified valuation methodology

¹³ Notice, Appendix.

¹⁴ Notice, paragraph 65.

for affiliate transactions involving either assets or services consisting of a hierarchy of (1) tariffed rates, (2) prevailing company price and (3) costs.

The Commission proposes to retain its requirement that affiliate transactions provided pursuant to a tariff be recorded at tariff rates, assuming the tariff is generally available, on file with a state or federal agency, and in effect. CBT recommends that this valuation methodology be retained.

With respect to prevailing company price for small Tier 1 companies, the 75% criteria applied to transactions between an affiliated company and non-affiliated company should not be adopted. If an affiliated company conducts any substantial business with non-affiliated companies and has a verifiable prevailing company price for the product or service, then the transactions with the carrier should be valued at the prevailing company price. This will greatly simplify the entire prevailing company price methodology for small Tier 1 companies. It will eliminate the measuring of outputs, the making of forecasts and the performing of true-ups; it will reduce the small companies' work effort and record keeping responsibilities; audits will be much more straightforward and less costly; and it will offer adequate protection for the ratepayer against cross-subsidization.

While fair market value can be estimated in a number of ways, such as competitive bids, a survey of suppliers and independent appraisals, nevertheless CBT believes that the comparison of costs to fair market value produces a minimal difference which is not justified by the work effort and auditing costs involved in determining fair market value. For the small Tier 1 companies CBT proposes the elimination of the fair market value comparison process. If a tariff or prevailing company price does not exist, then the transaction should be valued at "costs." The Commission has developed a

generic rate base methodology for the calculation of fully distributed costs.¹⁵ CBT recommends that the USTA Guide (Bulletin No. 92-8) on calculating a rate base and rate of return be adopted. The Guide was developed by USTA, working with the Commission staff, and has been in use for 2 years. The methodology is based on Generally Accepted Accounting Principles (GAAP), is measurable, and is auditable. The proposed methodology is for a company which follows Part 32 rules and accounting structure. The nonregulated affiliates do not follow Part 32 rules. Hence, the Commission proposal is inappropriate.

The Commission also discusses the rate of return to be used with the rate base in order to provide a return on investment.¹⁶ The Commission invites comment on state rates, blended rates, and optional incentive regulation rates that may be used by carriers in the cost calculations. CBT recommends that the Commission's authorized rate of return be used by small Tier 1 companies regardless of the type of regulation under which the carrier operates. This would reduce the complexity of the cost calculation immeasurably. Thus, the cost calculation for expenses and the rate of return would be greatly simplified, thereby reducing work effort, record keeping and auditing expenses, while continuing to protect the ratepayer from cross subsidization.

In this age of intense competition in the telecommunications industry, small Tier 1 companies need to have the burden of regulation eased if those companies are to control costs and compete successfully in the marketplace.

¹⁵ Notice, paragraphs 57-76.

¹⁶ Notice, paragraphs 66-71.

Conclusion

CBT believes that the amendments to the Commission's affiliate transaction rules proposed by the Notice are not only unnecessary but retrogressive. If any of those amendments are to be adopted, they should be severely limited as suggested herein, and consideration given to the burden that the small Tier 1 carriers will have to bear.

Respectfully submitted,



John K. Rose

William D. Baskett III
John K. Rose
FROST & JACOBS
2500 PNC Center
201 East Fifth Street
Cincinnati, Ohio 45202
(513) 651-6800

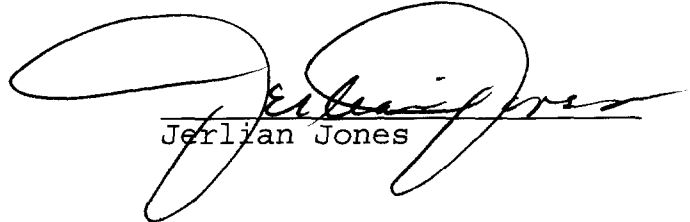
December 10, 1993

0068007.03

Attorneys for
Cincinnati Bell Telephone Company

CERTIFICATE OF SERVICE

I, Jerlian Jones, do hereby certify on this 10th day of December, 1993, that I have caused a copy of the foregoing Comments of Cincinnati Bell Telephone Company to be mailed via first class United States Mail, postage prepaid, to the persons on this service list.



Jerlian Jones

Mr. William F. Caton, Acting Secretary *

Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

International Transcription Services *

Federal Communications Commission
1919 M Street, N.W., Room 812
Washington, D.C. 20554

William A. Kehoe, III *

Accounting & Audit Division
2000 L Street, N.W., Suite 257
Washington, D.C. 20554